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THE STANDARD OIL AND AMERICAN TOBACCO CASES.

In a previous article¹ the writer attempted briefly to trace the development of (1) true contracts in restraint of trade, (2) monopolies and (3) restrictions upon competition, and of the law pertaining to each of them, and endeavored to show that the proper common law test of the first was their reasonableness as determined by the principal contracts (usually contracts of sale) to which they were ancillary, while the test of the two latter was their extent,—*i. e.*, whether they amounted to a practical control of the market for a useful commodity or for services. As there pointed out, the mistake was frequently made of applying the test of reasonableness to the latter as well as to the former. This mistake was probably partly due to the broadening of the meaning of the phrase "contracts in restraint of trade" far beyond its original scope, but would be of slight importance had the extent of the control of the market been adhered to as the standard by which the reasonableness of a monopoly or restriction upon competition should be determined, *i. e.*, if it had uniformly been held that monopolies and restrictions upon competition were unreasonable if they amounted to a practical control of the market, and reasonable if the control did not reach such an extent. Unfortunately, however, the extent of the control of the market was not always resorted to as the sole test of the reasonableness of the monopoly or restriction upon competition, and what might have been nothing more than a change in legal phraseology resulted in the consideration of many improper and collateral issues in determining the reasonableness and consequent validity of various forms of commercial and industrial combinations.

It is not the purpose of this article to treat any of the many economic questions that arise under the Sherman Anti-Trust Act or to discuss the problems connected with the manner of relief afforded by the decrees of the United States Supreme Court in

¹ U. of Pa. Law Rev., vol. 59, p. 61.

what are commonly known as the Standard Oil² and Tobacco Trust³ cases, but rather (1) to examine briefly the facts in those cases, (2) to determine the construction the court has now placed upon the Sherman Act, and (3) to comment on and criticise the decisions.

Before commencing this task, however, it may be interesting to note the part played in the three leading cases known respectively as the Trans-Missouri Freight Association Case,⁴ the Joint Traffic Association Case,⁵ and the Northern Securities Case,⁶ by present members of the court. Only two of them, Chief Justice White and Justice Harlan, were on the bench when the court rendered the first two of these decisions, with both of which Justice Harlan concurred while Chief Justice (then Justice) White dissented, filing a very strong opinion in the first named case. Justices McKenna, Holmes and Day had all taken their places on the bench before the Northern Securities decision was rendered. In that case an opinion holding the combination illegal was written by Justice Harlan, with whom Justice McKenna and Justice Day concurred, while the present Chief Justice and Justice Holmes wrote the two dissenting opinions. A perusal of the other cases arising under the Act will show that Chief Justice White and Justice Harlan have always been on opposite ends of the line, the former holding, where possible, that the Act did not apply to the combination before the court, the latter generally contending that its application was evident.⁷

(1) OUTLINE OF THE FACTS.

(a) *The Standard Oil Company.*

The development of the Standard Oil Company may be divided, as it was in the bill, into three periods,—(1) from 1870 to 1882; (2) from 1882 to 1899; (3) from 1899 to 1906.

² Standard Oil Company v. U. S., 221 U. S. 1.

³ U. S. v. American Tobacco Co., 221 U. S. 106.

⁴ U. S. v. Trans-Missouri Freight Association, 166 U. S. 290 (1897).

⁵ U. S. v. Joint Traffic Association, 171 U. S. 505 (1898).

⁶ Northern Securities Co. v. U. S., 171 U. S. 505 (1898).

⁷ See U. S. v. E. C. Knight Co., 156 U. S. 1 (1895); Hopkins v. U. S., 171 U. S. 578 (1898); Anderson v. U. S., 171 U. S. 604 (1898).

(1) In 1870 three separate partnerships engaged in the oil business organized the Standard Oil Company of Ohio, to which they transferred all their business. Others soon joined the combination till in 1872 the company had control of nearly all of the thirty-five or forty refineries in Cleveland. It then proceeded to acquire a large number of refineries in New York, Pennsylvania, Ohio and elsewhere, and obtained control of most of the pipe lines until in 1882 it held sway over ninety per cent. of the business of refining, shipping and selling petroleum in the United States. The following seem to be among the methods used during this period,—(1) obtaining preferential rates and rebates from railroads; (2) closing many of the plants acquired, and (3) placing others under apparently separate control.

(2) The second period of development extends from 1882 to 1899. In 1882 all or part of the stock of forty odd corporations and much of the property belonging to them and to many individuals were transferred to nine trustees who issued trust certificates therefor and who by 1888 had an average of over eighty per cent. control of thirty-nine corporations with a capital stock aggregating nearly \$48,000,000. In the meantime the Standard Oil Companies of New Jersey and New York were incorporated with \$3,000,000 and \$5,000,000 capital respectively, which amounts were shortly increased to \$10,000,000 and \$15,000,000. A decree of ouster was entered by the Supreme Court of Ohio against the Standard Oil Company of Ohio in 1892, at which time the trust controlled eighty-four companies. Under this decree the stock held by the trust in sixty-four of these companies was transferred to the remaining twenty, of which the Standard Oil Company of New Jersey was one. The situation does not seem to have changed much before the end of this period, during which the methods used were much the same as in the first.

(3) The third and last period embraces the years from 1899 till 1906 when the bill was filed. At the beginning of this period the powers of the Standard Oil Company of New Jersey were greatly widened. Its capital was increased to \$110,000,000, and to it were transferred all of the stocks and property formerly

held by the trust which now went out of existence. An idea of its powers may be gained from the fact that at the time the decree was entered by the lower court, it owned the entire stock of 16 corporations with an aggregate capital of over \$54,000,000, over ninety-nine per cent. of the stock of seventeen corporations with an aggregate capital of over \$75,000,000 and over fifty-five per cent. of the stock of five corporations whose capital aggregated over \$18,000,000. Some of these corporations in turn controlled other companies. Thus one of them, the National Transit Company, owned over ninety-seven per cent. of the stock of five corporations with an aggregate capital of nearly \$18,000,000. During this final period the methods adopted may be summarized as follows: (1) receiving from railroads rebates and preferences; (2) obtaining control of pipe lines and using unfair practices against independent pipe lines; (3) cutting prices at points where it was necessary to suppress competition; (4) spying upon the business of competitors; (5) operating bogus independent companies, and (6) eliminating competition among members by dividing the United States into districts, each of which was allotted to a member.

(b) *The American Tobacco Company.*

The development of what is commonly known as the Tobacco Trust may be divided into two periods,—(1) from 1890 to 1898; (2) from 1898 to 1907.

(1) In 1890 five competing cigarette manufacturers producing ninety-five per cent. of all domestic cigarettes and less than eight per cent. of domestic smoking tobacco, having previously engaged in a fierce trade war, combined in the American Tobacco Company, with a capital stock of \$25,000,000, which in 1891 was increased to \$100,000,000. In the eight ensuing years this company purchased eighteen tobacco companies, and in 1898, it controlled the manufacture of eighty-six per cent. of domestic cigarettes, twenty-six per cent. of all smoking tobacco, fifty-one per cent. of all little cigars, six per cent. of all snuff and fine cut tobacco, and over two per cent. of all cigars and cheroots manufactured in the United States.

Among the methods employed by it may be mentioned: (1) taking covenants from vendors of businesses purchased not to compete with it for long periods; (2) closing down many plants as soon as they were acquired; (3) engaging in ruinous trade wars with competitors who were unwilling to sell;⁸ and (4) endeavoring to keep up the appearance of competition by operating affiliated companies as though they were independent.

(2) In 1898, the plug war having terminated successfully, the Continental Tobacco Company was formed with a capital of \$75,000,000 (afterwards increased to \$100,000,000) and took over the plug business of the American Tobacco Company as well as that of five formerly competing companies who had been forced into submission. During this period, control was acquired over various branches of the tobacco business which were put in the hands of ostensibly independent companies,—*i. e.*, the snuff business was given to The American Snuff Company, the manufacture of tinfoil was put into the hands of the Conley Foil Company, the cigar business into the hands of the American Cigar Company, the manufacture of licorice was put under the control of The MacAndrews and Forbes Company, and the stogie and tobie business was given to the American Stogie Company. All of these concerns were controlled by the American Tobacco Company. In 1901, the Consolidated Tobacco Company was formed and acted as a holding company for the Continental and American companies until 1904 when all three were merged in the new American Tobacco Company, with \$180,000,000 capital. Up to the time of this merger either the American or Continental Company had acquired and closed up thirty competing concerns and had purchased many others which they continued to operate. Since that time the new American Tobacco Company had, before the bill was filed in 1907, purchased and closed four large plants and acquired control of eight others which were continued in operation. The extent of the control thus acquired is emphasized by the fact that many of the purchased concerns in turn controlled other companies engaged in

⁸ Exemplified by the plug war, during which the American Tobacco Co. lost \$4,000,000.

the various branches of the business. Through all these transactions the methods used with such effect in prior years and outlined above were relentlessly pursued until at length the English field, too, was invaded and the control of the new American Tobacco Company over the entire trade became almost absolute.

(2) CONSTRUCTION OF THE SHERMAN ACT.

With this brief outline of the most salient facts in the two cases let us pass on to an examination of the construction now placed upon the Sherman Act by the Supreme Court.

As the main battle raged around the meaning of the words "restraint of trade," it should at the outset be noted that the court has always been unanimous in holding that the phrase as used in the Act must be given the legal meaning it had at the time the Sherman Law was enacted, but there has been a wide difference of opinion as to what that meaning is. Thus in the Freight Association Case⁹ the majority of the court held that the words included all contracts, etc., that in any way in fact restrained trade whether valid or invalid at common law, while the minority, headed by the present Chief Justice, held them to include only those that were invalid at common law. The former majority view has now been definitely repudiated, and the view so ably set forth in the dissenting opinion in that case has been accepted by an almost unanimous court. Here and elsewhere in the opinions in the Standard Oil and American Tobacco decisions will be found clear echoes of passages in the dissenting opinions of Chief Justice White and Justice Holmes in the Freight Association and Northern Securities cases.

In this discussion no attempt will be made to separate the two decisions before us, for the one is but the supplement of the other and a clear view of the present construction of the Act can be gained only from the closest scrutiny of both decisions in conjunction with each other.

And first, let us commence our structure by laying down three broad principles as foundation stones:

⁹U. S. v. Trans-Missouri Freight Association, 166 U. S. 290, 328, 351, 353 (1897).

(1) The Act forbids only *undue* restraints of trade.¹⁰

(2) The only standard of what is an undue restraint of trade is that of reason.¹⁰ This standard is the same as that of the direct and indirect effect on trade which was laid down in the prior cases.¹¹

(3) The Act is not confined to contracts, combinations and conspiracies, but applies to all acts,—*e. g.*, mere acquisitions of property, etc., which unduly restrain trade.¹²

The difficulty of such broad propositions as these is that they are apparently but glittering generalities and are not of themselves sufficiently definite to enable one to determine whether or not a proposed course of action falls within the statute. Upon them, therefore, we shall attempt to build other more specific principles that may be gathered from the opinions in the two cases:

(1) Section 1 of the Act prohibits all contracts, combinations and conspiracies which unduly restrict competitive conditions or unduly obstruct the course of trade.¹³

(2) Section 2 prohibits all attempts to reach either of the ends prohibited by the first section,—*i. e.*, undue restrictions upon competition and undue obstructions of trade—even though the acts by which it is attempted to reach these ends do not fall within the first section.¹⁴ Such undue restrictions or obstructions may arise either (a) from the inherent nature of the contract, etc., or act itself, or (b) from the fact that it is entered into or done not for the purpose of reasonably forwarding personal interest but to injure others; and this purpose to injure others may be shown by the surrounding circumstances, such as the use of abnormal business methods, etc.¹⁵ (a) In other words

¹⁰ *Standard Oil Co. v. U. S.*, 221 U. S. 60, etc.; *U. S. v. American Tobacco Co.*, 221 U. S. 179.

¹¹ *Standard Oil Co. v. U. S.*, 221 U. S. 66.

¹² *Standard Oil Co. v. U. S.*, 221 U. S. 61; *U. S. v. American Tobacco Co.*, 221 U. S. 176-177.

¹³ *Standard Oil Co. v. U. S.*, 221 U. S. 58, 75 ff.; *U. S. v. American Tobacco Co.*, 221 U. S. 179.

¹⁴ *Standard Oil Co. v. U. S.*, 221 U. S. 61.

¹⁵ *U. S. v. Trans-Missouri Freight Association*, 166 U. S. 342; *U. S. v. Joint Traffic Association*, 171 U. S. 561.

there are certain contracts, etc., which restrict competition and obstruct trade to such an extent that they result in a practical control of the market and can at once, without reference to any of the circumstances which surround them, be held to fall beyond the "ulterior boundaries" fixed by the Act. A contract, not ancillary to any other, by which one attempted to bind himself not to engage in a trade for which he was fitted, would certainly fall beyond the boundary, and within this class would also fall such combinations as the Trans-Missouri Freight Association and the Joint Traffic Association by which all competition of railroads within a prescribed area was ended. This is evident, for the court in those cases expressly held that the intent of the parties there was immaterial. It should be particularly noted that if a contract, etc., falls within this class it is immaterial that it has been used to aid, not to injure, the public. Thus in the Freight Association and the Joint Traffic Association cases it was immaterial that the rates established were just and reasonable, for the combinations themselves unduly restricted competition, and the fact that they were not used to injure the public was irrelevant.¹⁶ It is doubtful whether an act, as distinguished from a contract, combination or conspiracy, could fall within this class.¹⁷ (b) On the other hand there are certain contracts, etc., and acts which in themselves do not restrict competition or obstruct trade to such an extent as to fall within the prohibition of the statute, but which, when couched in their surrounding circumstances, are seen to have been entered into or performed for the purpose of injuring others, and which for this reason are condemned by the Act. A marked example of such a transaction is to be found in the American Tobacco Case where one

¹⁶ This would seem to be a ground for the decision recently handed down by the Supreme Court of Missouri in the case of *Missouri v. International Harvester Co. of America* (not yet reported), under the Missouri Anti-Trust Act, (R. S., sec. 10, 301), which is closely parallel to the Sherman Act. The defendant was one of six companies, who to end a ruinous trade war, combined in a corporation with \$120,000,000 capital stock, controlling eighty per cent. of the trade, but which used its power to the advantage of the general public.

¹⁷ Thus, for instance, it would seem that a mere acquisition of property could not, without reference to the circumstances surrounding it, be held unduly to restrict competition.

corporation purchased many competing plants only to close them down, thus showing that the purchase, which, apart from the circumstance surrounding it, was perfectly legal, was not for the purpose of proper self-advancement but rather to injure others.

When we come to the further question of what are the surrounding circumstances from which the intent to injure others will be presumed we pass from law to facts. Though it is of course impossible to catalogue such circumstances, the two cases before us show that the presumption is irresistible where the following facts and methods exist: (1) the union of many corporations resulting in dominion over the trade in question; (2) a preceding trade war among the combining parties; (3) trade conflicts with competitors resulting in combinations, etc., with them; (4) a consciousness of wrong-doing as exhibited by constantly changing the form of substantially the same transactions; (5) the absorption of control over the elements essential to the trade and placing them in the hands of apparently independent companies; (6) purchasing competing plants only to close them; and (7) constantly recurring contracts by which others bind themselves not to compete with the combination. There are, of course, an unending number of other circumstances and combinations of circumstances which in a given case may be sufficient evidence of the wrongful intent, and how many of those enumerated would be necessary to raise the presumption of such intent must, in the very nature of things, depend on the facts of each case as it arises.

(3) Finally, the words "in part" as used in the second section have both a geographical and a distributive significance,—*i. e.*, the contract or act may fall within the statute even though the resulting restriction is confined to a portion of the United States and to only one of the classes of things which make up interstate or foreign commerce.¹⁸

Such was the construction put upon the Act by all of the members of the Supreme Court except Justice Harlan who tenaciously adhered to the views expressed in earlier cases that all contracts, combinations and conspiracies which in fact re-

¹⁸ Standard Oil Co. v. U. S., 221 U. S. 61.

strain trade are illegal, regardless of their validity at common law.

(3) COMMENT AND CRITICISM.

It now remains briefly to comment on and criticise the construction of the Act which has met with the almost unanimous approval of the highest court in the land. As a preliminary question it may be asked why the majority of that court examined so deeply into the Act and all that lies back of it, instead of merely holding, as Justice Harlan contended they should, that the combinations in question were illegal under any possible construction of the Act. The reason seems to be an economic and practical one, a conviction that it is impossible to understand how, under changing economic conditions, "the statute may in the future be enforced and the public policy which it establishes be made efficacious,"¹⁹ unless new rules be laid down or old rules re-stated.

Let us take up some of the objections strongly and almost bitterly urged by Justice Harlan in his dissenting opinions. First, Is the action of the court a piece of judicial legislation? Justice Harlan and those whose views ran along similar lines always contended that the Act prohibits all restraints of trade whether legal or illegal at common law. They were immediately confronted, however, with the necessity of excluding from the operation of the statute those contracts, etc., the restraint of which on interstate commerce was remote and negligible, and accordingly the standard of the direct or indirect effect of the contract on interstate commerce was laid down. And when subsequently they were confronted with a reasonable contract in restraint of trade using that phrase in its narrow sense it was unanimously held valid.²⁰ Nor can it be contended that the test laid down in the earlier cases was not whether the contract, etc., directly *restrained* interstate commerce, but rather whether it directly *affected* it (whether by way of restraint or not) and that it was

¹⁹ *Standard Oil Co. v. U. S.*, 221 U. S. 68.

²⁰ *Cf. U. of Pa. Law Rev.*, vol. 59, pp. 70-71; and see the earlier dictum to the same effect in *U. S. v. Trans-Missouri Freight Association*, 166 U. S. 329.

applied for the sole purpose of upholding the constitutionality of the Act under the Commerce Clause. This is true because (1) the court clearly stated in the case of *Hopkins v. The United States*,²¹ that "the contract condemned by the statute is one whose direct and immediate effect is a restraint upon that kind of trade or commerce which is interstate," and (2) in practice it is impossible that there should be a contract in restraint of trade, which directly affects interstate commerce and yet does not directly restrain such commerce. Even Justice Harlan, therefore, did not apply the Act to all contracts that in fact restrained trade but was forced to adopt a standard or arbitrarily to say that the Act was never intended to apply to a given restraint. As, therefore, a standard of what is a restraint of trade seems essential to the enforcement of the Act, it is submitted that it is no more judicial legislation to adopt the standard of due or undue, than to adopt the standard of direct or indirect, even though we may be of the opinion that the two standards are not the same and that the construction of the statute has in essence been changed by the two decisions under discussion.

This brings us to Justice Harlan's second fundamental objection,—that the decision in effect reverses all the former decisions of the court construing the Act. At the outset it may be admitted on the one side that under the Act as now construed the same conclusions could have been arrived at in each of the prior cases as were in fact reached, and on the other, as the court frankly admits, that much that was said in the earlier opinions not necessary to the decisions must be considered as overruled. There still remains the question, however, whether, after stripping prior opinions of all *obiter dicta*, the essential principles therein laid down are the same as those laid down in the cases before us. And first, as to the test by which to determine whether a given contract, etc., falls within the statute. As above pointed out, the test previously set up was whether interstate or foreign commerce was directly or indirectly restrained. In the *Standard Oil* opinion the court says that this is identical with

²¹ 171 U. S. 578, 592 (1898).

the test of reason which they have now laid down.²² From this it follows that every contract, etc., that directly restrains interstate trade is unreasonable, and one restraining such trade only indirectly is reasonable. There is no escape from this conclusion, and it would therefore seem that the decisions are not so revolutionary as some have supposed, though they have, it may be, opened the door to the consideration in the future of collateral and irrelevant issues in determining the reasonableness of a contract, combination or conspiracy, just as the application of the standard of reasonableness to monopolies and combinations to restrict competition did at common law.

While, therefore, some of the logic by which the court seeks to reconcile the present construction of the Act with that laid down in prior decisions, may seem to us so fine spun as to be difficult to follow through the maze of words, it would seem that the test laid down as to restraints of the first class,—*i. e.*, those which of themselves restrict competition or obstruct trade to such an extent as to fall within the prohibitions of the Act²³—are nearly, if not quite, identical. By emphasizing the extent of the restriction of competitive conditions as the test in this class, the court has substantiated the theory previously advanced²⁴ that the real result of the decisions under the Sherman Act has been to get back to the proper common law test of the validity of monopolies and combinations to restrict competition. It is submitted, however, that in two particulars the court has extended the Act so as to render illegal contracts and acts which both at common law and under the prior decisions would have been valid,—*i. e.*, in holding (1) that contracts and combinations which, apart from their surrounding circumstances, do not restrict competition or obstruct trade to such an extent as to fall within the Act, may come within its prohibitions if done with an intent not reasonably to further one's own interests but to injure others, and (2) that the statute applies to mere acquisitions of property

²² 221 U. S. 66.

²³ See *supra*, p. 317.

²⁴ U. of Pa. Law Rev., vol. 59, pp. 61, 73.

and other acts when done with a wrongful intent though no combination or contract is involved.

And finally, it is submitted that the two decisions under discussion, instead of emasculating the Sherman Anti-Trust Act, as so many have contended, have on the contrary extended its application and given it that elasticity which will allow it to meet changing economic conditions.

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